A Case for Free Trade

The United States and Globalization in Asia

Bernard Wasow

Has Asia grown at the expense of America? No, argues this economist. It may be more protectionist than the United States is, but free trade has helped us all. In response to occasional articles in Challenge, *he makes a case for free trade.*

FROM the time Admiral Perry forced open Japanese markets in 1854, one Asian economy after another has engaged with modern global capitalism. How have we been affected by Asia's expanding role in world trade? Far from our gunboat diplomacy of the nineteenth century, have we now become the victim rather than the aggressor in a global economic struggle? Many observers think so. They claim that the United States is being played for a fool in East Asia. Over the last thirty years, the story goes, we have opened our markets to imports from the newly industrializing countries, permitting them to export their way to riches while they suppressed wages at home and accumulated

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huge export surpluses. As two leading Asia experts put it, "The high growth rates achieved by many Asian countries have been a 'miracle' made in America. The United States has directly promoted this explosion of growth by accommodating to mercantilist, export-oriented Asian economic models despite their adverse impact on American economic interests."[1]

In fact, there is almost no truth to the story of Uncle Sam as the sucker for unfair trade. Our trade policy certainly benefits our trading partners, most of which are more protectionist than we are. Many studies have confirmed the importance of new exports for rapid income growth in developing countries, and the growth of both exports and incomes in much of Asia has been spectacular. But the notion that Asian countries have run huge, mercantilist, export surpluses and that these surpluses—counterpart of our deficit—support Asian economic growth at our expense is simply wrong. Globalization, the product of new technologies in transportation and communications, plus an enabling policy environment, has been vital to Asian countries, but their success has not come at our expense.

Business as Usual

From 1970 through 1996, Asian economic growth was indeed powered by an export boom. The rapid integration of Asian economies into the global trading system is illustrated in Figure 1. During this period, trade grew much faster than production throughout the region, including six of the developing economies most often identified with mercantilist practices: China, Korea, Indonesia, Thailand, Malaysia, and Singapore.[2] Income per capita in these countries grew by an amazing 6.2 percent per year, while trade per capita grew by 9.4 percent.[3] (Over this twenty-six-year period, average incomes grew almost fivefold while trade per capita grew more than tenfold.) But the fact that

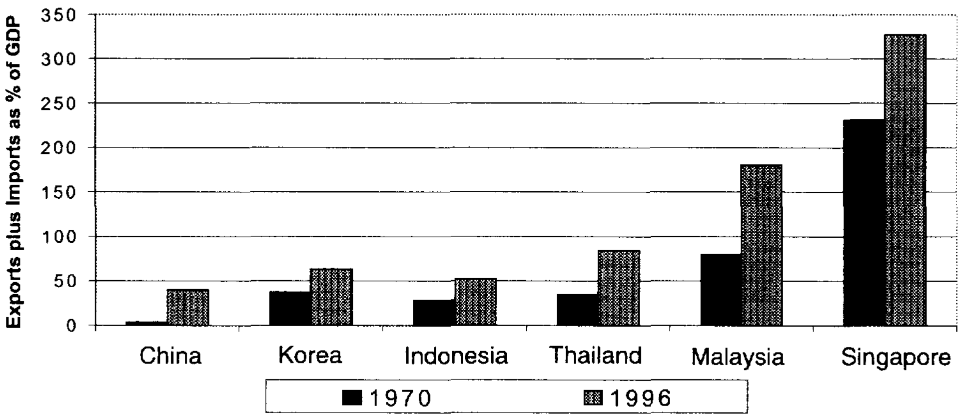

Figure 1. Opening of Asian Economies, 1970–1996

trade grew so rapidly does not by itself tell us anything about Asia's dependence on *net* exports to the rest of the world. In fact, the bulk of increased production in Asia has satisfied domestic demand: private consumption, government purchases, and investment at home. The boom in *gross* exports certainly was a crucial source of economic change, but *net* exports contributed little to total demand. Imports grew apace with exports. The growth of exports together with imports reflected growing *specialization* of Asian economies, not a mercantilist accumulation of export surpluses.

Before the economic crisis of 1997, growth in domestic demand closely matched growth in domestic production in each of these countries, while growth in imports closely matched growth in exports. The numbers are detailed below. In Figure 2, the 1970–1996 change in total production (GDP—gross domestic product), is represented by the leftmost bar of each country. Next to total production is a bar that represents the change in domestic demand for goods and services, that is, for consumption (C) plus investment (I) plus government purchases (G). Now, domestic production may be exported, rather than being used domestically, while domestic demand can be met by foreign as well as domestic sources. The final two bars represent the changes in exports (X) and imports (M).[4] The three bars on the right account for the leftmost bar: the change in GDP equals the change in domestic demand, plus the change in exports, minus the change in imports.

It is evident that in every one of these countries, the first two bars are close to the same size: The increase in domestic demand closely matched the increase in domestic production. For example, in Korea, GDP increased by $453 billion while domestic private consumption plus investment plus government spending increased by $468 billion. The counterpart of this outcome is that the increase in imports almost matched the increase in exports. Korean exports increased by $144 billion and imports by $159 billion. In fact, this same conclusion can be expressed in three equivalent ways: In Korea from 1970 to 1996, domestic demand grew slightly faster than production, imports grew slightly more than exports, and domestic investment increased slightly more than domestic saving. In China, Indonesia, Thailand, Malaysia, and Singapore, as well as Korea, the same broad conclusion holds: Growth in domestic production matched growth in domestic demand, growth in imports matched growth in exports, and growth in investment matched growth in saving. (In the United States over this same period, output grew by about $3.6 trillion while domestic demand increased by about $3.7 trillion.) There is no evidence in Figure 2 that from 1970 to 1996, Asian growth depended on bloated export surpluses or suppression of domestic demand.

Crisis

In 1997 and 1998, the patterns summarized in Figure 2 for the previous twenty-six years changed sharply. Financial panic led to the flight of capital from Asia, as wealth holders of the world scrambled to unload assets. The source of the panic and the moti-

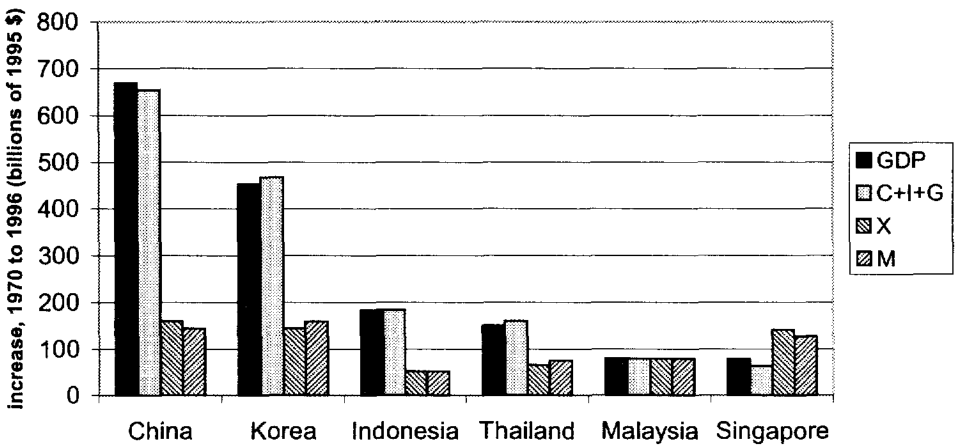

Figure 2. Sources of Demand in Asia, 1970–1996

vation of the world's wealthy will continue to be a topic of debate, but for our purposes it is enough to note that wealth owners in Asia and elsewhere, over a few weeks in the summer of 1997, decided that they wanted to sell Asian assets and buy other assets. As they all rushed at once to cash in, what was the source of the dollars that these rich folks removed? Some of the dollars came from the reserves that central banks keep for such emergencies. Some were lent to central banks by the International Monetary Fund (IMF). But a great deal of the fleeing capital was earned then and there: Exports were pumped out at a much higher rate than imports were purchased. Unlike the preceding twenty-six years, during which export revenues were used to pay for imports, in 1997 and 1998 countries needed an export surplus to finance capital flight. As Figure 3 shows, in Korea, Indonesia, Thailand, and Malaysia, total output (and working people's incomes) fell between 1996 and 1998. But domestic demand was reduced even more, as austerity measures squeezed every component of C + I + G. As a result, the crisis countries ran large export surpluses, evident in the large gaps between the first and second bars in Figure 3 (as well as the third and fourth bars).

This contraction in demand was no maverick policy, undertaken

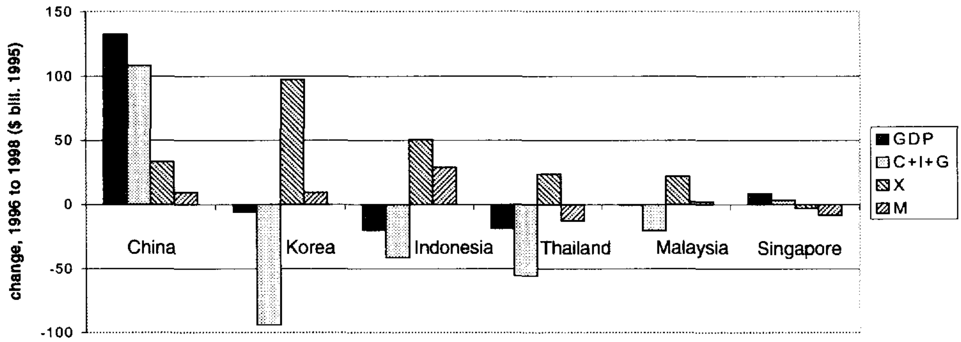

Figure 3. Sources of Demand in Asia, Crisis Years 1997 and 1998

in a beggar-my-neighbor spirit. Strict austerity was prescribed by the IMF. It permitted exports to expand even while production was falling. The crisis countries were able to provide asset holders with dollars exactly because they squeezed their citizens.

The IMF prescriptions certainly satisfied the interests of wealthy asset holders, but did they do so at the expense of Asian workers? In defense of the IMF, some have argued that the strict austerity was the best remedy among an array of bitter medicines. Defenders of the IMF claim that the long-run ramifications of default on external obligations, or imposition of capital controls, would have been more damaging to the interests of Asian workers than the programs adopted. But Malaysia's benign experience with capital controls suggests that these ramifications may not be so odious after all. Whether they helped workers in the long run—by preserving investor confidence in orderly markets—or simply squeezed workers to generate dollars for investors, there can be no doubt that the export surpluses that Asia produced after the 1997 crisis were a response to the programs of the IMF, not a mercantilist initiative of Asian governments.

The Future

In any case, the economic recovery after 1998 in most of East Asia suggests that we are likely to see the pre-1997 pattern of growth re-emerge. That is a pattern in which Asian economies grow rapidly, the fruit of their high investment in industry, infrastructure, and education. Asian producers, as they expand their exports, are likely to continue to challenge Western producers of manufactures. But Asian imports, too, will continue to expand, in spite of protection. As Asia continues to specialize, the rest of the world will be forced to undertake complementary adjustments. Fortunately for American workers, most of us produce services that are not traded much. But workers in many manufacturing industries can expect challenges directly from factories in Asia as well as factories throughout the world that are competing not only for the U.S. market but also to satisfy Asia's appetite for imports. Other American manufacturing and agricultural producers will benefit from the growth of Asian imports. It is incumbent on American society to help workers shift from declining to growing sectors.

A return to business as usual in Asia will carry financial as well as trade implications for the United States. The capital that left Asia in 1997 and 1998 found its way into safe harbors, especially U.S. capital markets. That capital flow, which helped finance large trade deficits in the United States, will slow and perhaps reverse as emerging markets regain some of their allure. Of course, if enthusiasm for our "new economy" wears thin, nobody can guarantee that the United States will not be the next miracle that falls out of favor with the wealthy. Crises of globalization in the late twentieth century may have failed to reveal mercantilist machinations, but they certainly revealed the instability of global capital markets. Today, an entire country can face the sort of "run on the bank" that eventually led to enhanced financial regulation and active central banking in this country in the century that followed our Civil War. Like support for displaced workers, governance of the global financial system should be an urgent policy priority.

The prospect of international financial instability, coupled with sustained intense trade competition, may be daunting, but it does have its good side. As other parts of the world continue to grow rapidly, American workers in our export industries will find their services very much in demand. And all of us, as consumers, will continue to enjoy high-quality goods at low prices. We also can gain satisfaction as we see hundreds of millions move out of poverty in Asia. No one can imagine the contributions to literature, art, science, and technology we will reap as well nourished, well educated new generations throughout the world are able to realize far more of their potential.

Notes

1. Selig Harrison and Clyde Prestowitz, "Overview: New Priorities for U.S. Asia Policy," in *Asia After the Miracle*, ed. Harrison and Prestowitz (Washington, DC: Economic Strategy Institute, 1998).

2. My data source, the World Bank's *World Development Indicators, 2000*, does not publish information about Taiwan, a country that should be added to this list. Singapore is no longer a developing country, but it was for most of the period under review.

3. Trade grew faster than production in the United States as well, with income per capita expanding by about 1.7 percent and trade per capita by 4.7 percent. Exports plus imports in the United States expanded from about 11 percent to almost 25 percent of gross domestic product (GDP).

4. GDP is measured at market prices in constant 1995 dollars. Export and import shares are applied to GDP to get X and M. C + I + G is the residual.